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EEB/IFD/OMA, DRL/ILCSR-MITTELHAUSER  
STATE PLEASE PASS TO USTR FOR DAVID BISBEE  
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SUBJECT: PRIME MINISTER OUTLINES BULWARKS AGAINST  
"INFLATION TYPHOON"

11. SUMMARY. Prime Minister Hun Sen took his economic battle plan to the airwaves April 23, outlining the causes of Cambodia's increasing inflation, enumerating policies the government has enacted in recent years to create a robust economy, and listing possible future steps to further combat inflation and potential food shortages. Seizing the opportunity of a nationally televised semi-annual meeting between government officials and the private sector, the PM abbreviated the government-private sector dialogue in favor of a four hour speech about Cambodia's economic situation. With an eye towards voters, he emphasized that Cambodia did not have a rice shortage and detailed a number of past actions and possible next steps to combat rising food prices and other inflation. Most significant among these plans were eliminating customs duties and VAT on food and agricultural imports, providing additional credit to rice millers and the state-owned rice company, ending a ban on Vietnamese pork imports, and increased wages for garment workers and civil servants. The PM also said that he would end a ban on rice exports, but might impose export taxes on rice if Cambodia's food security situation worsened dramatically. End Summary.

12. The Government-Private Sector Forum is a meeting of the Prime Minister and his full cabinet with the representatives of eight joint government and private sector working groups tackling issues from agriculture to industrial relations. The semi-annual event is nationally televised and attended by hundreds of diplomats, officials, and business people. This meeting, the 13th forum, was held on April 23. In the past, each working group gave an overview of concerns in their area and asked for specific government interventions, which the PM usually approved or declined on the spot. This meeting was notable in that the government-private sector dialogue was dramatically shortened to allow for lengthy remarks about inflation from the Prime Minister.

Finance Minister Predicts 7.2% Growth in 2008  
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13. The opening speech of Keat Chhon, Minister of Economics and Finance, was heavy in its praise for the Prime Minister, noting that the economy has grown at an average of 11.1% per year since the last national elections in 2004. However, global financial events have hurt Cambodia's economic

performance and near term economic outlook, with 18.7% inflation in January 2008 and GDP growth expected to slow to 7.2% in 2008. The Minister mentioned briefly that the Prime Minister was keeping the "inflation typhoon" under control through a combination of monetary and fiscal measures. (Note: A sidebar, printed in the Minister's remarks but not read, acknowledged the possibility that increased government spending designed to alleviate the impact of inflation on the poor could in fact end up spurring further inflation. However, the note concluded, the current inflation is "imported" rather than having primarily Cambodian causes, and is unlikely to be worsened by Cambodian government efforts. The document quotes Deutsche Bank executive Josef Ackerman as denying the market's self-healing power and cites the USG's bail out of Bear Stearns as further rationale for government intervention. End Note.)

#### PM Weighs in on Private Sector Requests

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14. On the substance of the Government-Private Sector Forum, Prime Minister Hun Sen announced decisions about requests made from the eight working groups that constitute the Forum.

He agreed to eliminate customs duties and suspend VAT on food, agricultural inputs such as machinery and animal feed, and several metals. He pledged to reduce customs tariffs on organic chemicals. He declined to establish a convention center in Phnom Penh, saying that private sector developers already had plans to build several exhibition halls in the capital. Plans to increase the reserve requirements at banks will go forward despite objections from the banking industry.

Hun Sen said that he agreed in principle with proposals to draft new laws on trade unions and the creation of a labor court. (Comment: International Labor Organization

PHNOM PENH 00000353 002 OF 004

representative John Ritchotte told us neither of these proposed laws were discussed in the Industrial Relations Working Group. It is not clear what the proposed law on trade unions would say. The existing Labor Law refers to a not-yet-established labor court, and the embassy and the ILO have previously been concerned about whether the creation a labor court, in a country with a famously corrupt judiciary, would undercut the innovative and transparent Arbitration Council, which was created with U.S. Department of Labor and USAID funds. End Comment.)

#### Global and Domestic Factors Fuel Inflation

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15. Turning his attention to Cambodia's increased inflation, the PM said that global factors and Cambodia's own economic success lie behind the recent increases in Cambodian inflation. Global causes include the five-fold increase in global oil prices since 2003, increased consumer demand for food and other goods, lower agricultural production due to shifts from food to bio-fuel production and poor weather, increased population, and the depreciation of the dollar. Cambodia is particularly sensitive to the dollar's depreciation, the PM noted, because Cambodia's economy is dollarized and the vast majority of its exports go to the U.S., while it imports most of its goods from other Asian countries whose currencies are appreciating against the dollar. Domestically, high economic growth rates, skyrocketing real estate values, increasing numbers of tourists, and the surge of broad money (cash plus funds in checking and savings accounts and non-institutional money market funds) have fueled the demand for consumer goods, Hun Sen stated.

16. Throughout his speech, the PM was quick to assuage potential fears of food shortages by emphasizing that Cambodia has enough food to feed its people and is, in fact, a net rice exporter. He noted that Cambodia had recently shipped 6,000 tons of rice to Senegal. He also asserted that while urban populations may feel the pinch of higher food

prices, these same dynamics lead to higher incomes for farmers. With so many urban workers having family back in the provinces, the economic effects of the increased rice price may be evened out within families, he said.

#### Prudent Government Policies Have Kept Economy Growing

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¶7. Highlighting Cambodia's prudent fiscal and monetary policies, the Prime Minister enumerated actions that the government has taken in the past--both specifically in response to the recent increase in inflation and more generally over the past several years--to keep the Cambodian economy growing without overheating. In April 2008, the government gave garment and shoe factories a three year exemption from the 1% pre-paid tax on profits. This was part of a deal that gave these factories the financial flexibility to agree to give workers a USD 6 per month cost of living adjustment to last through 2010.

¶8. The Prime Minister has taken several steps intended to secure the country's food supply. He banned rice exports on March 26, 2008, later announcing that he would lift the ban effective May 26, 2008. (Note: After appeals from the Commerce Minister, Hun Sen later agreed that three eastern provinces with high rice production could export rice, mostly to Vietnam. Consumer goods have long been smuggled into and out of the country to avoid paying customs duties, and we have heard reports that rice is now being smuggled out in defiance of the ban, but we do not know on what scale this is occurring. End Note.) Hun Sen said that he had also ordered the state-owned rice company Green Trade to sell rice from their stock; provided additional financing to be used as working capital by Green Trade and the Cambodian Rice Millers Association; and rescinded an August 2007 ban on the import of Vietnamese pork products. (Note: While the PM claimed credit for lifting the ban as an anti-inflationary measure, the ban was initially imposed in response to an outbreak of

PHNOM PENH 00000353 003 OF 004

porcine respiratory and reproductive syndrome, also know as blue ear disease. Hun Sen noted that the disease was now present only in isolated pockets in Vietnam. End Note.)

¶9. Over the past several years, the Cambodian government has increased the base salaries of government officials, military personnel, and retirees by 10-20% per year, Hun Sen said, a rate significantly exceeding inflation. The government doubled the allowances given to the spouses and children of working, retired, and disabled officials and soldiers. (Comment: This move is largely rhetorical and symbolic as these allowances are quite small even in a Cambodian context. The spouse allowance increased from 63 cents per month to USD 1.25, and the child allowance rose from 75 cents per child per month to USD 1.50 per child per month. End Comment.) By using lower, out-of-date prices for calculating the taxes on gasoline for consumer use and diesel fuel for electricity generation, the government has cut the effective tax rate on these products. As a result, the price of gas has risen more slowly in Cambodia than in neighboring Thailand or Vietnam. Similarly, electricity prices are lower than they would be otherwise, the PM stated.

#### Battling Inflation and Food Insecurity: The Road Ahead

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¶10. Cambodia's economy will face an unfavorable environment in the medium term, the Prime Minister asserted, explaining that many of the factors fueling inflation now would likely continue. He noted that there were some silver linings to this situation. For example, Cambodia will be a cheaper and more attractive tourist destination thanks to the dollar's decline.

¶11. The National Bank will adopt a cautious monetary policy, Hun Sen said, by increasing the reserve requirement at banks

from 8% to 16%; encouraging banks with strong balance sheets to invest some of their assets abroad; establishing guidelines aimed at reducing lending in some high-risk sectors, especially real estate; and slowly de-dollarizing the economy.

¶12. Fiscal policies will also be carefully developed in order to keep inflation in check and promote continued economic growth. Hun Sen called for government spending to remain within the parameters of the balanced 2008 budget. The government will aim to increase revenue by reducing smuggling, tax evasion, and tax fraud. The government will reduce or eliminate customs tax and VAT on food and agriculture imports, offsetting this loss of revenue with higher taxes on luxury goods such as cars, alcohol, and cosmetics. The Prime Minister called for better enforcement of property and unused land taxes, and the implementation of a capital gains tax. Finally, the government may consider introducing export taxes on rice if a severe shortage of rice develops within the country.

¶13. The Prime Minister also enumerated other government policies which could boost agricultural production if needed. Licensing rice storage, processing, and export firms would help collect data about rice production and rice levels and would impose some degree of control on the process. Finally, the government and private sector could provide low interest loans to the Rice Millers Association to increase its ability to store rice for later sale for domestic consumption. The government could encourage the creation of community-based farmers associations and then direct financing, seeds, and technical assistance to these organizations.

Comments

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¶14. Hun Sen clearly saw the nationally televised Government-Private Sector Forum as a campaigning opportunity and did his best to appeal to voters. His speech sought to reassure voters with repeated assertions that Cambodia produces enough rice to feed its people and has even exported 6,000 tons of rice to Senegal in recent weeks. His rants

PHNOM PENH 00000353 004 OF 004

were this time focused on populist themes, including defending people in Kandal province from a land grab, and, unusually, did not criticize the international community at all. The PM also targeted the opposition, warning that this could be the last Government-Private Sector forum if the CPP does not win the election.

¶15. But for all his politicking, the PM's speech was most notable for the overall soundness of his economic analysis, actions, and plan. International observers consistently give Cambodia high marks for its fiscal responsibility, trade and investment openness, and overall economic mindset. Hun Sen has been consistent in his economic goals, repeating in both good times (considering how oil revenue might be spent) and bad (the current inflation situation) that the government's rectangular development strategy will guide its decisions. The PM has now backed away from earlier reactionary moves, announcing the immediate end to the ban on Vietnamese pork imports and the May 26, 2008 expiration of the rice export ban. With an eye toward the international community, he was careful to note that his new proposed emergency measures to limit rice exports--potentially imposing export taxes--fall within WTO rules. The most dubious parts of his plan are his monetary efforts. In Cambodia's highly dollarized and open economy, the government has little control over money supply. MUSSOMELI